

MEMORANDUM OF LAW

DATE: May 21, 1993

TO: Mary Rea, Assistant Director, Risk Management
Department

FROM: City Attorney

SUBJECT: Dependent Care Expenses

You have requested a legal opinion regarding whether a child who has turned thirteen during the year is eligible for dependent care reimbursement under the City's cafeteria plan. In this particular instance, the employee prepaid his dependent care expenses for the entire year, knowing the child would turn thirteen in November and become ineligible for dependent care reimbursement at that point. Nevertheless, the employee is still requesting reimbursement.

The dependent care reimbursement plan is established as an employee benefit provided through the City's flexible benefit plan pursuant to 26 U.S.C. section 125. One of the main requirements of a reimbursement program established under section 125 is that the program exhibit a risk shifting and risk distribution element. Essentially, this means that each party to the agreement must bear a portion of the risk. For example, the flexible benefits plan provides, at the beginning of the year, for benefits for the entire fiscal year. If an employee selects a dollar amount for dependent care reimbursement, uses the entire amount for a qualified person in the first two or three months of the fiscal year, and then terminates employment, the City must reimburse the full amount despite having lost the employee's services for the balance of the year. Conversely, if the employee selects a dollar amount for dependent care and is unable to use the entire amount set aside during the course of the fiscal year, any residual monies are lost to the employee and revert to the employer because a section 125 cafeteria plan does not permit the deferral of compensation into the following year. Additionally, unused monies may not be refunded as a cash benefit. As explained in 26 C.F.R. section 1.25-1 question and answer 18,

Dependent care assistance provided

under a cafeteria plan will be treated as provided under a dependent care assistance program only if, after the participant has elected coverage under the program and the period of coverage has commenced, the participant does not have the right to receive amounts under the program other than as reimbursements for dependent care expenses.

This risk shifting element that allows neither refunds nor deferrals is essential to maintaining the qualified tax status of the City's section 125 cafeteria plan.

26 U.S.C. section 129, dealing with dependent care assistance programs, indicates that a qualified person for dependent care reimbursement is defined in 26 U.S.C. section 21(b) and is "a dependent of the taxpayer under the age of thirteen and with respect to whom the taxpayer is entitled to a deduction under section 151(c)." 26 C.F.R. 1.44-1(c)(3) provides that "The status of a person as a qualifying individual is determined on a daily basis. Thus, if a dependent or spouse of a taxpayer ceases to be a qualifying individual on September 16, the dependent or spouse is treated as a qualifying individual through September 15 only." The Flexible Benefits Plan Summary highlights the importance of this limitation by including the following language:

Your Eligible Dependents

Your day care expenses are eligible for reimbursement under the City's plan if your expenses are for a dependent who is:

- . your child who is younger than age 13
- . dependents who you may claim an exemption for Federal income tax purposes (sic).

If your child turns 13 during the plan year, you cannot stop your contributions to the account. Plan your expenses carefully. (Emphasis in original.)

To allow for reimbursement for dependent care regardless of the fact that the child has turned thirteen during the course of the fiscal year would jeopardize the City plan's tax qualified status.

CONCLUSION

The provisions for dependent care reimbursement are clearly enunciated in the flexible benefits plan. Employees are fully apprised of the age qualifications and "use it or lose" features of the reimbursement plan. Therefore, continuing to reimburse for dependent care for a child who has reached the age of thirteen would be inappropriate and contrary to law.

If you have additional questions, please contact me.

JOHN W. WITT, City Attorney

By

Sharon A. Marshall

Deputy City Attorney

SAM:mrh:pev:352.3(x043.2)

cc: Eugene Ruzzini

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